

In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:)	
)	Adversary Proceeding
PENNY H. FLYNN)	
(Chapter 13 Case <u>92-40789</u>))	Number <u>93-4013</u>
)	
<i>Debtor</i>)	
)	
)	
)	
PENNY H. FLYNN)	
)	
<i>Plaintiff</i>)	
)	
)	
)	
v.)	
)	
INTERNAL REVENUE SERVICE)	
and)	
UNITED STATES OF AMERICA)	
)	
<i>Defendants</i>)	

MEMORANDUM AND ORDER

A trial of the above-captioned case was conducted on February 2, 1994. On May 13, 1994, this Court issued a verdict in favor of Plaintiff, Penny H. Flynn, and against

Defendant, United States of America, in the amount of \$30,277.55. By order of the United States District Court on March 31, 1995, that decision was affirmed in part, reversed in part, and remanded with instructions in accordance with the District Court's memorandum. In light of the District Court's opinion, a hearing was held on October 25, 1995, at which time the parties still disputed the application of the relevant provisions of the Bankruptcy Code. The parties subsequently submitted briefs in regard to their positions. After considering the evidence, applicable authorities and the argument of counsel, I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

The following facts are not in dispute. Debtor filed a petition for relief under Chapter 13 of the Bankruptcy Code on April 17, 1992. Debtor properly scheduled the Internal Revenue Service ("IRS" or "Service") as a creditor in her case, and the IRS duly received notice of the pendency of Debtor's case pursuant to notice given by the Clerk of this Court. On August 26, 1992, the IRS filed two proofs of claim in Debtor's case, and both claims were allowed for payment under Debtor's Chapter 13 Plan, which was confirmed on November 19, 1992. Copies of the Order of Confirmation were mailed to all creditors scheduled by the Debtor, including the Service.

On January 14, 1993, Debtor received a letter from NationsBank of Georgia,

N.A., ("NationsBank") dated January 12, 1994, informing her that the IRS had served the bank with a levy on her checking account. This levy remained in place until January 21, 1993, when NationsBank received notification by fax and mail that the levy was released. On January 26, 1993, Debtor filed the instant adversary proceeding to recover damages for the adverse consequences she suffered as a result of the levy. As mentioned earlier, this Court held a hearing in this adversary proceeding on February 2, 1994, and issued a written order on May 13, 1994. Flynn v. Internal Revenue Service and United States, 169 B.R. 1007 (Bankr.S.D.Ga. 1994).

In the order, this Court held that the IRS willfully violated the automatic stay provision of 11 U.S.C. Section 362(h) and waived sovereign immunity under 11 U.S.C. Section 106(a). The Court awarded Debtor \$5,588.55 for compensatory damages-\$588.55 in out-of-pocket expenses, consisting of \$120.00 in returned checks, \$360.00 in lost wage charges, and \$108.55 in travel expenses and \$5,000.00 in damages for emotional distress, due to the embarrassment, humiliation, and shame she suffered as a result of the levy. Further, punitive damages of \$10,000.00 were awarded based on "[t]he IRS's recalcitrance and indifference to the fact that its current system guarantees that it will repeatedly violate the automatic stay." Id. at 1024. Attorney's fees of \$2,709.00 were also awarded based on counsel's expenditure of 27.09 hours at the rate of \$100.00 per hour. Finally, at the conclusion of the May 13, 1994, Order, I required that, "Plaintiff's judgment against the

United States of America be set off against any remaining allowed claims which the Internal Revenue Service has in Plaintiff's Chapter 13 case."

On May 20, 1994, the United States filed a Notice of Appeal challenging the verdict. After briefing was completed and before a decision was rendered, the Bankruptcy Reform Act of 1994 ("Act") was passed on October 22, 1994. Accordingly, the District Court ruled in light of the new Code provisions.

In sum, the District Court affirmed this Court's finding that the IRS committed a willful violation of the automatic stay thereby entitling Debtor to compensatory damages, costs and attorney's fees under 11 U.S.C. Section 362(h). However, after considering Section 113 of the Bankruptcy Reform Act of 1994, the District Court reversed this Court's award of punitive damages against the United States.¹ In addition, because Section 113 of the Act, made retroactive by Section 702, provides that awards for attorneys' fees against a governmental unit be consistent with 28 U.S.C. Section 2412(d)(2)(A), the

¹ The relevant portions of Section 113 of the Act provides:

(a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:

(1) Sections ... 362 ...

(2) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery *but not including an award of punitive damages*.

Pub. L. 103-94, 108 Stat. 4177-18, §113 (codified as amended at 11 U.S.C. § 106) (emphasis added).

District Court vacated the attorneys' fee award of \$2,709.00 and remanded the issue to this Court to determine an appropriate fee award in light of the Bankruptcy Reform Act of 1994. Thus, on March 31, 1995, the District Court affirmed the award of compensatory damages, reversed the grant of punitive damages, and vacated the attorneys' fee award to be reconsidered in light of the new Act. The IRS declined to file a timely appeal of the District Court's decision.

At the time of this hearing, the parties agreed on the calculation of damages. Debtor is entitled to \$11,460.30. Of this amount, Debtor will receive \$5,588.55 in compensatory damages comprised of \$588.55 for reimbursement of her actual costs and \$5,000 for emotional distress. Attorneys' fees in the amount of \$5,871.75 will also be allowed. Punitive damages are not allowed.

The main issue of contention concerns whether or not the IRS may still set off Debtor's award of \$11,460.30 against the Service's allowed general unsecured claim of \$7,915.53 in Debtor's Chapter 13 since Debtor converted the case to a Chapter 7 on November 1, 1994 and allegedly discharged the tax claim. IRS claims that after set off Debtor is entitled to \$3,544.77; where as, Debtor claims that the IRS must remit the complete award of \$11,460.30 because the debt has been discharged.

The Service's main argument is twofold: (1) this Court's Order of May 13, 1994, required set off "against any remaining allowed claims which the IRS has in Plaintiff's Chapter 13 case"; and (2) the government's tax claim was never discharged because Debtor failed to bring an adversary proceeding pursuant to 523(a)(1).

Debtor contends that the previous Order has been vacated by the District Court and that this Court should consider the Service's claim in accordance with Debtor's recent discharge in Chapter 7. Further, Debtor asserts that the Service's consent to the re-classification of their claims as unsecured and to their full discharge upon completion of the Chapter 13 plan effectively bars the re-litigation of the claim's status through the doctrine of *res judicata* and additionally makes the claims susceptible to a general Chapter 7 discharge. Moreover, Debtor believes that the requirement of filing an adversary complaint to determine dischargeability has been obviated by the previous litigation of the claim's status in the Chapter 13.

Because this Court finds the language of 11 U.S.C. 348(a) together with the reasoning of U.S.C Section 348(f) controlling, Debtor's assets, specifically the compensatory damages and attorneys' fees arising from a post-petition violation of the automatic stay, while property of the Chapter 13 estate are no longer part of the estate upon conversion to Chapter 7 and, therefore, the Service must remit Debtor's entire claim.

CONCLUSIONS OF LAW

In pertinent part, 11 U.S.C. Section 348(a) and (f) provide,

(a) conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, *does not effect a change in the date of filing of the petition, the commencement of the case, or the order for relief.*

(f)(1) Except as provided in paragraph (2), when a case under Chapter 13 of this title is converted to a case under another chapter under this title--

(A) property of the estate in the converted case shall consist of property of the estate, *as of the date of filing of the petition*, that remains in the possession of or is under the control of the debtor on the date of conversion;

(2) If the debtor converts a case under Chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate *as of the date of conversion*.

11 U.S.C. § 348(f) (emphasis supplied). Congress recently enacted Section 348(f) by Section 311 of the Bankruptcy Reform Act of 1994.² This Section represents an attempt by Congress to resolve a split between the circuits about an interpretation of 348(a) and accordingly, what property is in the bankruptcy estate when a debtor converts from chapter

² Bankruptcy Reform Act of 1994, Pub. L. 103-394 (Oct. 22, 1994).

13 to chapter 7.³

Prior to the enactment of Section 348(f), an initial line of cases defined a bankrupt's estate which had been converted from a Chapter 13 to a Chapter 7 only to include property originally in the estate as of the filing of the initial Chapter 13 petition.⁴ In general, these cases held that 11 U.S.C. Section 541 defined the property of the estate as of the date of commencement. Because Section 348(a), which is clearly entitled "effect of conversion," reinforced as a general rule that the date of the initial filing is the date of commencement for converted estates, these courts strictly construed Sections 541 and 348(a) and as a consequence excluded from the Chapter 7 estates property which the debtor obtained post-filing and pre-conversion.

However, an alternate line of cases recognized the potential for abuse "that any Chapter 13 debtor who received a windfall of any sort could simply convert to Chapter 7 and deprive the Chapter 13 creditors of the benefit of the funds." In re Bartlett, 149 B.R.

³ "This amendment overrules the holding in cases such as Matter of Lybrook, 951 F.2d 136 (7th Cir. 1991) and adopts the reasoning of In re Bobroff, 766 F.2d 797 (3d Cir. 1985)." H.R. Rep. No. 103-394, 103rd Cong., 2d Sess. 42-43 (Oct. 4, 1994).

⁴ See In re Hudson, 103 B.R. 781 (Bankr.N.D.Miss. 1989); In re Bullock, 41 B.R. 637 (Bankr.E.D.Pa. 1984); Oliphant v. Amarillo Pantex Federal Credit Union, 40 B.R. 577 (Bankr.N.D.Tex. 1984); Hannan v. Kirschenbaum, 24 B.R. 691 (Bankr.E.D.N.Y. 1982).

446, 448 (Bankr.W.D.Tex. 1992).⁵ These courts effectively removed Section 348(a) from their analysis and included within a converted Chapter 7 property which the debtor obtained post-filing and pre-conversion.

Congress has since eliminated this controversy for all cases commenced after October 22, 1994, by enacting Section 348(f)(1) which adopts the reasoning of the initial line of cases. In effect, Congress has decided that requiring property obtained after the date of filing to be part of the Chapter 7 estate would create a serious disincentive to Chapter 13 filings.⁶ Moreover, in recognition of the concerns of the Seventh Circuit, Congress also enacted Section 348(f)(2) which permits a Court

⁵ See also, In re Lybrook, 951 F.2d at 137 (Judge Posner, writing for the Court upheld the reasoning of the bankruptcy judge and also added that "an equally good alternative from a purely semantic perspective is that the conversion from Chapter 13 to Chapter 7 does not affect the bankrupt estate but merely assures the continuity of the case for purposes of filing fees, preferences, statute of limitations, and so forth.")

⁶ "For example, a debtor who had \$10,000 equity in a home at the beginning of the case, in a State with a \$10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a \$10,000 second mortgage in the chapter 13 case, creating \$10,000 in equity, there would be a risk that the case would be lost if the case were converted to chapter 7 (which can occur involuntarily). If all of the debtor's property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home, to realize the \$10,000 in equity for the unsecured creditors and the debtor would lose the home." H.R. Rep. No. 103-394, 103rd Cong., 2d Sess. 42-43 (Oct. 4, 1994).

to recognize the conversion date as the date of commencement if a debtor converts in "bad faith."

Because this case was commenced prior to October 22, 1994, this Court recognizes that it is not bound by Section 348(f). However, when viewing the language of Sections 541(a) and 348(a) together, I hold that the "commencement" of a case converted from a Chapter 13 to a Chapter 7 occurs on the date of the filing of the original petition and not on the date of conversion. I further hold that property accumulated by a debtor after filing Chapter 13 may not be considered property of the Chapter 7 estate in accordance with the Hudson line of cases and the intent of Congress expressed in Section 348(f).

In the present case, Debtor filed for Chapter 13 relief on April 17, 1992. On May 13, 1994, this Court held that the IRS intentionally violated the Section 362 automatic stay through its post-petition intentional acts. Of course, it is axiomatic to hold that a property right arising from a Section 362 violation occurred after the filing of the petition. Pursuant to 11 U.S.C. Section 1306, this recovery became property of the estate and so long as the Chapter 13 case was pending was properly set off against the Service's claim.⁷

⁷ (a) Property of the estate includes, in addition to the property specified in section 541 of this title, (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first;

However, as previously mentioned, upon conversion this property right did not become part of Debtor's chapter 7 estate. Rather, the Chapter 7 estate included only the property owned by Debtor at the commencement of the Chapter 13, which does not include a post-petition claim for violation of the automatic stay. Because Section 106(c) clearly states that, "[n]otwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim or interest against such governmental unit *that is property of the estate*," and because this asset is not property of the Chapter 7 estate, the Service is not entitled to a set off.⁸ In addition, this Court holds that no evidence exists to support a contention that Debtor has acted in bad faith.

Lastly, this Court declines to decide whether Debtor has discharged its debt owed to the Service. Pursuant to rule 7001, Debtor brought this adversary proceeding to recover money and/or property and not to determine the dischargeability of a debt. Therefore, the issue is not properly before this court at this time.

ORDER

¹¹ U.S.C. § 1306.

⁸ The Service implicitly suggests in its brief that the set off metaphysically occurred at the instant that this Court issued its Order of May 13, 1994 requiring set off. However, this assertion is incorrect because the Service delayed the finality of the Order when it elected to appeal the award of attorneys' fees and not remit the directed amount to the Chapter 13 trustee. Thus, rights under Section 106(c) must be considered in light of Debtor's conversion during the appeal process.

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS
THE ORDER OF THIS COURT that Defendant, United States of America, remit to
Plaintiff, Penny H. Flynn, the sum of \$11,460.30 in satisfaction of the judgment previously
rendered in this case.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of December, 1995.